INFORMATION BULLETIN

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Changes to the tax credit for the development of e-business

This information bulletin describes the changes to the refundable tax credit for the development of e-business.

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Finances Québec

CHANGES TO THE TAX CREDIT FOR THE DEVELOPMENT OF E-BUSINESS

In the March 13, 2008 Budget Speech, a refundable tax credit was introduced for e-business development in information technology.

Briefly, this tax credit, which has a rate of 30%, is granted to an eligible corporation regarding the salaries paid to eligible employees carrying out eligible activities.

Essentially, this tax credit was introduced to consolidate the development of the information technology sector throughout Québec.

Monitoring since the introduction of this measure has brought to light the need to make certain adjustments to its eligibility conditions to better reflect its objectives.

Business productivity growth is tied to the use of information technologies in manufacturing and management processes. While some businesses are in a position to develop, internally, applications specific to their business processes, they often turn to specialized firms that, by carrying out multi-sector mandates, have developed more diversified expertise.

Accordingly, given the accelerating pace of technological change, the ability of such specialized firms to quickly develop new solutions, on the basis of the technologies and needs of their clients, makes it easier for all such clients to adopt technologies.

In addition, unlike businesses whose activities in the information technology sector are carried out mainly for internal purposes, specialized firms that carry out mandates for external clients are subject to strong global competition.

Moreover, the arrival of companies in Québec can also contribute to the consolidation of the information technology sector where the activities carried out by such companies provide substantial support for other activities carried out outside Québec.

Accordingly, changes will be made to the tax credit for the development of e-business to make it easier for corporations operating in the information technology sector to qualify and to ensure that the tax assistance is granted, barring exceptions, regarding activities carried out for applications external to the business processes of the corporation that carries them out. Changes will also be made to the notion of eligible activities to better delimit its application.

❑ Eligible corporation

Under the existing terms and conditions, to receive the tax credit for the development of e-business, a corporation must obtain, annually, an eligibility certificate from Investissement Québec confirming, among other things, that eligible activities constituted at least 75% of its activities for the taxation year.

■ Criterion relating to the proportion of eligible activities

The condition requiring that the proportion of eligible activities be at least 75% may appear restrictive for a corporation that, while carrying out all of its activities in the information technology sector, cannot achieve the required threshold regarding its eligible activities.

Consequently, a change will be made to this eligibility condition to replace the requirement relating to the proportion of eligible activities with a more flexible requirement. Accordingly, to receive the tax credit for the development of e-business, activities in the information technology sector must constitute, for the taxation year, at least 75% of the activities of the corporation.

In this regard, activities of the information technology sector mean the activities included under code 541510 of the North American Industry Classification System (NAICS code).[1]

This NAICS code covers establishments whose primary activity consists in supplying expertise in the field of information technology. This notion of establishment whose primary activity consists in carrying out certain specific activities will not be applied to determine whether activities in the information technology sector constituted at least 75% of a corporation's activities.

The criterion that will be considered for the purposes of such determination will be the corporation's gross income. A corporation will therefore be considered to have carried out at least 75% of its activities in the information technology sector where the gross income from such activities represents 75% or more of its total gross income with regard to either the taxation year preceding the one covered by the application for an eligibility certificate, or the taxation year covered by such application. This condition, which constitutes a non-tax parameter, will be administered exclusively by Investissement Québec.

Should the taxation year preceding the one covered by the application for an eligibility certificate have less than 183 days, the gross income considered will be that of the last taxation year prior to such given taxation year that had more than 182 days.

■ Criterion relating to services provided

As mentioned above, some businesses are in a position to develop applications specific to their business processes. While such activities otherwise constitute activities of the information technology sector, their distribution is generally limited to the corporation that carried them out or to member corporations of the corporate group of which it is a part.

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1 The description of this code is available on the Statistics Canada website: http://www.statcan.ca

Moreover, in certain cases, such activities, while carried out for internal purposes, may lead to the development of applications that will be used exclusively outside Québec and contribute to the consolidation, in Québec, of the information technology sector.

Accordingly, to direct the tax assistance towards corporations that face strong global competition and to encourage the location and expansion of businesses in Québec, an additional criterion will be added to the notion of eligible corporation.

A corporation may qualify as an eligible corporation where at least 75% of its activities carried out in the information technology sector consist of services ultimately provided to a person[2] with whom it is at arm's length[3] or of services relating to applications developed by the corporation that will be used exclusively outside Québec.

In this regard, the services provided by a corporation to the members of a cooperative or of a federation of cooperatives will be considered services provided to a person with whom it is not at arm's length where the corporation providing the services is not at arm's length with the cooperative or the federation of cooperatives.

The gross income from information technology activities will be the criterion considered for determining whether at least 75% of the activities carried out by a corporation in the information technology sector consist of services ultimately provided to persons with whom it is at arm's length or of services relating to applications developed by the corporation that will be used exclusively outside Québec.

Accordingly, a corporation may qualify as an eligible corporation where its gross income from information technology activities, attributable either to services provided to persons with whom it is at arm's length or to services relating to applications used exclusively outside Québec, represents 75% or more of the gross income from its information technology activities, with regard to the taxation year covered by the application for an eligibility certificate.

Concerning the component relating to services ultimately provided to persons with whom the corporation is at arm's length, the statute that will contain the non-tax parameters of certain fiscal measures will use the same notion of non-arm's length as that stipulated in the tax legislation, with the necessary adaptations in relation to the situation described above where services are provided by a corporation to the members of a cooperative or federation of cooperatives. For greater clarity, Investissement Québec may require information from Revenu Québec for the administration of this component.

Moreover, concerning the component relating to applications developed by the corporation that will be used exclusively outside Québec, Investissement Québec will indicate, if necessary, the proportion of the corporation's gross income from its information technology activities that is attributable to this second component.

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2 For the purposes of this rule, a person includes a partnership.

3 The expression "services ultimately provided to a person" does not cover services provided to the final consumer of the goods and services supplied by such person but rather the services provided to the businesses and organizations that will be the direct users of the applications developed by the corporation.

Lastly, in the course of determining satisfaction of the criterion relating to an application's exclusive use outside Québec, Investissement Québec may consider that such criterion is satisfied, even though an application is used in Québec, where such use, in Québec, is negligible compared to the overall use of such application. In this regard, Investissement Québec will in particular have to consider the impact of the application on the growth, in Québec, of the activities relating to its use as well as the competitive impact of the increase such activities on companies that already carry out similar activities in Québec.

❑ Eligible activities

For the purposes of the tax credit for the development of e-business, the expression "eligible activities" means the following activities:

— information technologies consulting services relating to technology, systems development, e-business processes and solutions (for instance, strategic planning, reconfiguration of business processes and technology architecture design);

— development, integration, maintenance and evolution of information systems (for example, distribution packages and computer software and programs) and technology infrastructures (for example, upgrading technology architecture and integration of hardware and software components);

— design and development of e-commerce solutions (for example, portals, search engines and transactional websites);

— development of security and identification services (for instance, electronic imaging, artificial intelligence and interface) relating to e-commerce activities (for instance, security over internet networks).

Two changes will be made to the notion of eligible activities to better delimit its application.

First, activities relating to the maintenance and evolution of information systems carried out by an eligible corporation will constitute eligible activities only if they are incidental to the development and integration activities carried out by the eligible corporation.

Second, the notion of eligible activities will be clarified so that activities that are not linked to e-business cannot constitute eligible activities for the purposes of this tax credit.

❑ Application date

These changes will apply regarding salaries incurred by an eligible corporation and paid to eligible employees after March 13, 2008 and before January 1, 2016.